

General Information Letter: General summary of withholding law.

February 25, 2002

Dear:

This is in response to your letter dated January 8, 2002 in which you state the following:

This letter is in reference to my employer and their refusal to withhold Illinois Income Tax from my paycheck. I was told that I could ask for a legal letter ruling regarding this matter, which is the intent of this correspondence.

The Facts

- I am an Illinois resident
- Employer: COMPANY, STREET ADDRESS, CITY, IN ZIP CODE
- Position: District Sales Manager with sales responsibility in the following states: IL, WI, MN, MO, KS, NE, ND, SD, IA
- Work from a home office, with no company base of operations in the state of Illinois. Direction is taken from the headquarters in Indiana.
- Significant portion of my duties are conducted in the state of Illinois
- Employer refuses to withhold Illinois Income Tax stating their accountants told them it was not required to withhold state tax for any out of state employees.
- Federal Income Tax is being withheld from my paycheck
- I meet all of the guidelines for the following localization test:

- The employee's service is **not** localized in any state, but
- some of the service is performed in Illinois
 - the base of operations or the place from which the service is directed or controlled is **not** in any state in which some part of the service is performed, **and**
 - the employee is an Illinois resident.
- I do not meet any of the exemption criteria in either the limited exceptions test or the "When am I **not** required to withhold Illinois Income Tax" section.

I would like to compel my employer to begin withholding Illinois Income Tax, if they are required to do so. If the state of Illinois has no power to enforce this, I also need to know that. Please let me know at your earliest convenience what can be done regarding this matter.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

The Illinois Income Tax Act ("IITA") imposes a tax measured by net income on individuals for the privilege of earning or receiving income in or as a resident of Illinois. Accordingly, the ultimate responsibility for payment of the Illinois income tax rests on you.

Pursuant to Section 701 of the IITA, every employer maintaining an office or transacting business within Illinois is required to withhold income tax on *compensation paid in this State if federal withholding is also required*. The Revenue regulations (86 Ill.Adm.Code Section 100.7010) provide that *compensation is paid in this State if*:

- A) The individual's service is localized in this State because it is performed entirely within this State;
- B) The individual's service is localized in this State although it is performed both within and without this State, because the service performed without this State is incidental to the individual's service performed within this State; or
- C) The individual's service is not localized in any state but some of the service is performed within this State and either; the base of operations, or if there is not a base of operations, the place from which the service is directed or controlled is within this State, or the base of operations of the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

For your convenience, enclosed please find a copy of 86 Ill.Adm.Code Section 100.7010.

If under Section 100.7010 compensation is considered paid in this State, then the entire amount of such compensation is subject to Illinois withholding, and the employer is responsible for fully withholding Illinois income tax from wages. This appears to be the issue under the facts set forth in your letter. Be advised, however, where the Director of Revenue has entered into a reciprocal withholding exemption agreement with the taxing authorities of a state which imposes an income tax on compensation, each state's respective residents will be exempt from withholding in the nonresident state on their compensation paid in the nonresident state. This latter part does not apply in your case since Illinois does not currently have a reciprocal agreement with Indiana.

For your information, compensation will not be subject to withholding, and an employer will not be required to withhold, under IITA Section 701(a)(1) if after application of Section 100.7010 the compensation is not considered paid in this State. However, under Section 701(a)(2) and (b) any payment (including compensation) by a payor maintaining an office or transacting business in Illinois but which does not meet the tests in Section 100.7010, will still be subject to Illinois withholding where certain conditions are present. If the recipient of such payment is a resident of Illinois, the payment is included in the recipients' base income, the payment is subject to federal withholding and the payment is not subject to withholding by another state, then the payment will be deemed compensation paid in this State by an employer and subject to Illinois withholding by the employer. (See IITA Section 701(a)(2) and (b)). If, however, such payment is subject to withholding by another state, a signed declaration by the payee to that effect will relieve the payor of the requirement to withhold Illinois income tax on the payment. (See 86 Ill.Adm.Code Section 100.7030(c)(2), a copy of which is enclosed). As mentioned above though, your situation seems to be covered by 86 Ill.Adm.Code 100.7010. Therefore, your employer should be withholding Illinois income tax.

With respect to "compelling" your employer to withhold Illinois income tax, please be advised as follows. Section 706 of the IITA provides that if an employer fails to deduct and withhold Illinois income tax as required, and the amount required to be deducted and withheld is paid, the tax shall not be collected from the employer. However, the employer shall not be relieved from liability for

penalties and interest as indicated in Section 1002(d) of the IITA. The burden for ensuring that the correct amount of Illinois income tax is paid timely ultimately falls on the taxpayer. Using your situation as an example, where the employer fails to withhold Illinois income tax as required, it is your responsibility to make estimated tax payments. As seen above, the Department of Revenue can punish the employer with penalties and interest. On the other hand, where some or all of the Illinois income tax is withheld by the employer, but not paid over to the Department of Revenue as required, the taxpayer is relieved of responsibility for paying the tax under IITA 601(b)(1) which states that "any amount withheld during any calendar year pursuant to Article 7 from compensation paid to a taxpayer shall be deemed to have been paid ..." in a timely manner.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax